No. 16253

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WILLIAM A. WYLIE, Trustee in Bankruptcy of the Estate of CLAIR V. WARD, Bankrupt,

Appellant,

vs.

CLAIR V. WARD,

Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

BRIEF OF APPELLEE.

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BRIEF OF APPELLEE.

Statement of the Case and Facts.

The principal question involved in this appeal is the sufficiency of the evidence to support the findings of the Referee.

The trial court may take into consideration the interest of a witness in the result of an action in determining the credibility of such witness. Therefore, it becomes important not to overlook the fact that while the record, on its face, shows that the specifications of objections to the bankrupt's discharge were filed and this appeal is prosecuted in the name of the trustee in bankruptcy, the real party in interest and the prosecutor thereof is the U. S. Rubber Company, which we shall also refer to as

"U. S. Rubber." Indeed, the Referee so considered these objections early in these proceedings when he stated [R. p. 146]: "What I have in mind here is that while these objections were filed by the trustee, they are in reality the objections of the U. S. Rubber Company."

The record of the Clerk of this Honorable Court will also, no doubt, show that the U. S. Rubber Company, and not the estate of the bankrupt, is bearing the costs of this appeal. The record of the trial discloses the extreme interest of the U. S. Rubber Company and of its counsel and the total lack of interest of any other creditor. [See argument of counsel for U. S. Rubber with Referee over Referee's decision beginning at R. p. 414.] In reality, as observed by the Referee, this is a proceeding prosecuted by the U. S. Rubber, and at its expense, and it should have the frankness and courage to come out in the open and say so.

The Bankrupt Was Closely Connected With U. S. Rubber Company for Thirty Years.

Mr. Ward, the bankrupt, was a customer and had an agency agreement with U. S. Rubber for a period of thirty years, dating back to 1923. [R. pp. 108-109, 234.] The relationship was very close and U. S. Rubber knew every detail of Ward's business and of his financial condition without resort to financial statements. [See testimony of Ward beginning at R. p. 239.]

Ward's business was something more than the average run of service stations, and sold tires in large volume to

large users of tires, such as trucking companies, the County of Los Angeles, and others. It was a 12 pump, 12 drive way station. [R. p. 440.]

Ward was located in Alhambra, California, and had this large place of business, with 20 to 25 employees [R. p. 106], including three girl bookkeepers. He sold gas, oil, tires and other auto accessories [R. p. 109], and shortly prior to 1950, he sold radios and televisions, which resulted in his distressed financial condition in the early part of 1950. [R. p. 241.] Mr. Ward supervised the keeping of the books, but he did not actually make the entries. [R. p. 107.]

In the early part of 1951, Mr. Swartz [R. p. 244], the U. S. Rubber Company's comptroller came out from New York and brought several officials of the company along with him, including Mr. Bowers [R. pp. 248-249], an auditor, who took over complete charge of Ward's bookkeeping and set up a change in Ward's bookkeeping system. Bowers had full authority to direct the entire accounting system. We shall subsequently show that it was the system of bookkeeping set up by U. S. Rubber Company's auditor Mr. Bowers [R. p. 276], of which U. S. Rubber now complains.

Mr. Ward bought tires from U. S. Rubber and resold them to his customers on retail, wholesale and commercial levels. [R. p. 109.] He had received credit from U. S. Rubber since 1923. [R. p. 109.]

Ward was one of U. S. Rubber's largest dealers in Los Angeles County. He sold in excess of $10,000,000.00 of

U. S. Rubber's merchandise over the period of years and in excess of $700,000.00 of said company's merchandise [R. p. 240], in the last 24 months.

Prior to 1950 Mr. Ward took on additional merchandise, such as radios, televisions, etc., and when the television market dropped in or about 1950 [R. p. 514], Mr. Ward became financially involved to such an extent that the head officers and auditors came out here from U. S. Rubber's head offices in New York and spent one full week in Ward's office *in the examination of all books and records and familiarizing themselves with Ward's business.* [R. pp. 241-249.] They learned then from said investigation that Ward was insolvent. [R. p. 246.] Mr. Bowers, who was field auditor for U. S. Rubber, was one of these officers. [R. pp. 241-264.] Mr. Bowers not only made a complete audit of Ward's records at the time, but had supervision of Ward's records from February, 1950, for a period of about 18 months, and thereafter made occasional visits "as he chose to come in and check with us, and all phases of the operation of the business was fully discussed with him at all times."

The financial statements on many occasions, including some of those objected to, were prepared under the supervision of Mr. Bowers, who was in Ward's office making up these statements. [R. p. 253; see also Bankrupt's Ex. 8.] The first six of the financial statements offered in evidence were in the handwriting of Mr. Bowers, who, as before stated, was U. S. Rubber's officer. In other words, U. S. Rubber was making Ward's statements for delivery to itself. [See also R. 319-322.]

Mr. Ward factored certain accounts receivable with Pasadena Finance Company, Atlas Factors, and People's Finance. [R. p. 691; also Ward's testimony generally and at p. 157.] The accounts were sold with a reserve being held against the sale. [R. pp. 159-165.]

Growing out of the audit and investigation made by U. S. Rubber, as above related, Ward gave U. S. Rubber $30,000.00 cash and a series of notes for $2,000.00 each, which covered the entire amount Ward then owed U. S. Rubber. These notes were executed *before any of the financial statements herein complained of were given,* and the same were payable one each month thereafter for a period of 40 months. Mr. Ward made all payments on these notes each month as they became due, and also kept the account for merchandise purchased and sold each month paid up-to-date. [R. p. 274.] It should be observed that the extension notes were given and accepted before any financial statements were issued.

And, in May, 1953, and prior to May 19, 1953, the day on which counsel for the trustee states the U. S. Rubber attached Ward's place of business, Ward delivered to U. S. Rubber checks to pay the May, 1953, current running account in full, and U. S. Rubber had these checks, which were good and could have been cashed, in their possession and did not reject them or return them to Ward until 10 days after the attachment. [R. p. 274.] We attempted to show the reason for this vicious and unwarranted action upon the part of U. S. Rubber, as well as the motive for the objection to the discharge and would have done so,

had we not been stopped by the Referee. [R. pp. 277-279.] It has always been the bankrupt's contention that no money was due U. S. Rubber from Ward when the attachment was levied; that this wrongful and malicious action on the part of U. S. Rubber forced Ward into an assignment proceeding and subsequently into involuntary bankruptcy.

These are reasons why U. S. Rubber prefers to press its objections in the name of the trustee. It has come to realize, also, that unless it can crush and suppress the effectiveness of the bankrupt as a tire merchant, it has created in this territory a most formable competitor. We believe this shows an interest which affects the credibility of its employees as witnesses.

Bankrupt's Individual Assets as Distinguished From Partnership Assets.

Mention is made of certain individual assets of Mr. Ward listed in the financial statements here involved, but it is important to remember that no individual property of Mr. Ward was ever listed in any of these financial statements here complained of such as his home or the Seal Beach lot, but instead Mr. Ward's individual property was listed as being of a value of $51,200.70. The U. S. Rubber Company, on the first six financial statements prepared by its own field auditor who had complete access to all of Mr. Ward's records, listed this same figure in the statements which were admittedly prepared in Bower's own handwriting. [See Bankrupt's Ex. 8.]

Items of Credit Extended After 1950 by U. S. Rubber to the Bankrupt.

It is important to remember that the numerous notes which Mr. Ward executed in 1950 in favor of U. S. Rubber were all executed before the financial statements complained of. Therefore, that extension of credit was given prior to the financial statements and said statements could have in no way influenced the extension of this credit by notes. It will be noted from a reading of the evidence heretofore cited that officers of U. S. Rubber told Ward that he was insolvent at the time the notes were executed. The only credit extended during the time the financial statements were being received by U. S. Rubber was monthly sales from consigned merchandise. [R. p. 169.] These accounts were paid monthly.

Harry Stout, who was the credit manager for U. S. Rubber from January, 1951, to the time of his testimony, was the third witness called. Mr. Stout testified [R. pp. 166-186] that he normally received the monthly statements from the bankrupt between the 5th and the 10th of the following month. When he received the statement [R. p. 169], he analyzed it to see whether or not Ward *was making progress* and the statement itself was then forwarded to the New York office with Mr. Stout's recommendation. The witness testified that after he received this statement, he continued to extend credit to Mr. Ward, but it appears this credit was upon a "consigned basis." It should be noted that this testimony does not disclose that this credit was extended upon the strength

of or in reliance upon the financial statement. U. S. Rubber counted its merchandise on the 20th of each month. [R. p. 170.]

With reference to the consigned merchandise, Mr. Stout testified [R. p. 170]:

> "The tires remained at his premises at all times. He was able to sell any or all of them at his own discretion. At or about the 20th of each month an inventory would be taken."

Other Evidence.

Not only did all the "Big Brass" of U. S. Rubber come here with their auditors and spend a week at Mr. Ward's office in 1950, but they left their field auditor in charge to set Ward's books up to his own liking. The company's auditor made Ward's financial statements in his own handwriting for six months and directed Ward's bookkeepers how and what to do. Ward testified that he gave them full and complete information with reference to his financial condition and made all of his papers, books and records available to them. He told Mr. Swartz that the home was in joint tenancy with his wife. [R. p. 243.]

The Specifications of Objections Involved in This Appeal.

Although the referee ruled adversely to the contention of U. S. Rubber upon each specification of objection, the appeal is only upon specifications of objections numbers 1, 3, 4, 5, 11d and 12. We prefer to deal with each of these separately rather than in "shotgun" fashion as appellant has done, although much of the same evidence applies to all objections.

ARGUMENT.

The Problems Here Involved Require Expert Accounting of the Highest Order.

Fortunately for the bankrupt, the Referee in this case is an able accountant in his own right, and although the U. S. Rubber Company's contingent were able to confuse him upon a few of the issues for awhile, he finally, after hearing further evidence, saw the light and ruled in favor of the bankrupt upon all counts. As a matter of fact, counsel for the trustee is an able accountant, and the bankrupt because of his thirty years' experience with U. S. Rubber and their manner of concealing the profits by paying certain bonuses, was able to dig out certain facts from the records. Otherwise, he would have been hopelessly lost in the confusion of figures.

Rules Which Govern on an Appeal.

In a very recent case, *In re Inman,* 157 Fed. Supp. 506, decided December 9, 1957, the Court, in sustaining a referee's finding upon an objection to the bankrupt's discharge, says (p. 508):

> ". . . The authority hereinbefore cited hold that on a petition to review the Court cannot be compelled to search the record for error, and this Court will not undertake to do so."

And in paragraph No. 6 of this opinion, page 510, the Court says:

> "General Order in Bankruptcy No. 47, 11 U. S. C. A. following section 53, provides that the district judge '. . . shall accept his (the Referee's findings of fact unless clearly erroneous . . .,' and the rule is well established that 'When the findings of a

referee are based upon conflicting evidence involving questions of credibility, and the referee has heard the witnesses and observed their demeanor, great weight attaches to his conclusions . . . the district judge . . . should not disturb his findings unless they are manifestly unsupported by the evidence.' *In re Musgrave,* D. C. N. D. Va. 1939, 27 F. Supp. 341, 343. See *In re Ouellette,* D. C. Me., 1951, 98 F. Supp. 941; *In re Roar,* D. C. E. D. Ky., 1939, 28 F. Supp. 515; 2 Collier on Bankruptcy, Sec. 38.28 (14th ed. 1956).

"After reading the entire record this Court has found it impossible to conclude that the Referee was clearly erroneous in any of his findings of fact or that he erred in his conclusions of law. Such are, therefore, adopted as the findings and conclusions of this Court, the petition for review is denied, and the order of the Referee is affirmed."

To the same effect are:

In re Florsheim (S. D. C. D.), 24 Fed. Supp. 991;

Humphreys Gold Corp. v. Lewis (9 Cir.), 90 F. 2d 896;

Century Indemnity Co. v. Nelson (9 Cir.), 90 F. 2d 644;

Inland Power & Light Co. v. Greiger (9 Cir.), 91 F. 2d 811.

General Order No. 47 of the Supreme Court says that the district judge ". . . shall accept his (the Referee's) findings of fact unless clearly erroneous . . . ," and the courts of this and other jurisdictions have constantly refused to interfere with the referee's findings where

same are based upon conflicting evidence involving questions of credibility, etc., and as pointed out, the Court will not search the record in order to try to find error.

And counsel's pointing out the most favorable evidence in favor of the reviewing party will not suffice where the Referee's findings, holding to the contrary, are under attack. We mention this because counsel for the appellant here has made reference to only a very small part of the testimony received in this case. In addition to the oral testimony received over a three year period, involving hearings and rehearings of all these issues, there were a mass of documents received in evidence to which very slight reference has been made.

Keeping in mind that Ward had an agency agreement with U. S. Rubber for 30 years, is further evidence that the company was as familiar with Word's business, his liabilities and his assets as Ward was himself, and the Referee properly concluded that U. S. Rubber did not rely upon these statements in extending credit, but rather upon its own knowledge based upon years of experience, and based upon the information furnished the Rubber Company's accountant, and the Company's monthly inventory.

As shown by Mr. Stout's testimony quoted above, U. S. Rubber took a count and inventory of the tires and merchandise on the 20th of each month. Every time Ward sold a tire the company knew about it very soon afterwards.

The Referee points out [R. p. 170] during Mr. Stout's testimony that he did not do anything new affirmatively every month, to which Stout agrees and says: "We honored his orders for additional merchandise to be shipped

into the consignment, to replenish the tires or goods that were sold."

There appears to have been $50,463.00 consigned inventory on or about February 28, 1953.

At [R. p. 171], the following questions were asked of Mr. Stout and the following answers given:

> "Q. Now, would you have continued that merchandise with Mr. Ward if you had not received this statement? A. When it was due I would have asked him for the statement. It was our practice to get one, whether or not I might have continued it. I might have for a few days, but certainly it was on the basis of his sending us his financial information that we continued to go along with him."

It will be noted that the witness does not say that he would have discontinued the credit arrangement if he had failed to receive the monthly statement. At [R. p. 172], it was stipulated that Mr. Stout's testimony would be the same with reference to the other monthly statements and that he would testify he did rely upon the other statements "to the extent that he has testified here." He was very evasive and did not testify that he relied upon the financial statement, and under this type of unsatisfactory testimony, the Referee was right under all of the evidence in finding there was no reliance.

When Mr. Stout said that they honored Ward's orders for additional merchandise to be shipped into the consignment, to replenish the tires or goods that were sold, he did not say that this was done upon the reliance on the financial statement.

The Referee's remark [at R. p. 178] is important in connection with this evidence. [See also R. pp. 252-263, where exhibits received.]

Then, of course, there was the testimony of the expert C.P.A., Hugh W. Friedman, produced by U. S. Rubber [beginning at R. p. 187], with reference to the $51,200.70 figure, covering Mr. Ward's individual assets, but nothing was produced which was very convincing to the Referee. The Referee was not interested in nice bookkeeping, but rather in knowing whether or not there were intentional false entries. [R. p. 219.]

SPECIFICATION OF OBJECTION No. 1.

Referee's Finding No. V in Findings on Specification of Objection No. 1.

Because of the importance of this particular finding in relation to all the above referred to evidence, as it pertains to the review upon the first five specifications of objections, we quote it in full:

> "Finds that the bankrupt, Clair V. Ward, under different names and entities, from time to time, had an agency franchise agreement and did business on a credit basis with the United States Rubber Company for a period of approximately thirty years immediately preceding the filing of bankruptcy herein; that certain of its auditors and officers were in Los Angeles from New York City in September or October of 1950, when a credit extension arrangement was agreed to, and prior to agreeing to any credit extension and further credit arrangement, said auditors, officers and officials of said United States Rubber Company remained at the place of business of the bankrupt, for a period of seven days or more, where

a complete check and audit was made of all of the books and records and financial affairs of the partnership of which the bankrupt was then a partner, as well as the said bankrupt's personal assets; that the officials of said United States Rubber Company were given full and complete co-operation of the bankrupt, and access to all records of the bankrupt, both personal or partnership, in making their check and audit.

"That Pressley M. Bowers, who was then the field auditor of the United States Rubber Company, was one of the above officials referred to; that he started work on the books of the bankrupt in October, 1950, and remained there on a permanent basis until August 1, 1951, and thereafter would return from two to five days each month until February, 1952; that the said Bowers set up a new set of books and a new bookkeeping system for the bankrupt and gave instructions to the bankrupt's bookkeepers as to how entries should be made and as to what information the financial statement mentioned in paragraph 3 of the 'First Objection' should contain; that the said Bowers, as United States Rubber Company's field auditor, made, in his own handwriting, several such financial statements for the bankrupt, and that the bankrupt's bookkeeper prepared the financial statements referred to in said paragraph 3 under the direction of said Bowers.

"Finds that the United States Rubber Company took a monthly inventory of the bankrupt's tires during the period of time in question, and was thoroughly familiar with the nature and extent of the bankrupt's business and of his financial condition and activities,

and that said United States Rubber Company did not rely upon said financial statements in extending credit to the bankrupt at any time during the period from October, 1950, to the date of bankruptcy, and further finds that none of the financial statements mentioned in paragraph 3 of the 'First Objection' were intentionally false. The Court further finds that this finding, herein numbered '5', shall be considered as a part of the findings upon Specification of Objections of numbered 1, 2, 3, 4 and 5 as amended, without the necessity of repetition."

The evidence is clear that Ward's individual and partnership records were produced and his financial condition was thoroughly discussed with U. S. Rubber and U. S. Rubber knew as much about it as Ward did himself. Ward told Swarts that the home was in joint tenancy. [R. p. 243.] It was not misled or deceived in any way, nor was there any attempt to mislead or deceive it. The evidence cited shows that U. S. Rubber was not looking to Ward's home as a means of payment. [See R. pp. 336-340; also pp. 260-261.]

Third Specification of Objection.

This specification involves the sale of the Seal Beach lot which was individually owned by Mr. Ward.

He did sell this lot in September, 1952, for $3,250.00 cash plus a transfer to Ward of other real property of the approximate value of $4,350.00; that the cash which the bankrupt received from the sale of said real property was first deposited in his personal bank account, where it rightfully belonged. It was then later deposited in the partnership account and an entry was made upon the

partnership books giving Mr. Ward credit for advancing the partnership this sum of money. Mr. Ward, after the sale of the Seal Beach lot, did not make an adjustment of the $51,200.70 figure because he felt he was no richer or poorer after selling the Seal Beach property; he still had a lot, and he had advanced to the partnership his personal funds, and the partnership was charged therewith, and owed him this amount. [R. p. 134—see also beginning p. 130.] Mr. Ward testifed that he informed Mr. Stout of this sale and obviously there was no intent to mislead or deceive anyone. [R. p. 273.] In view of the Referee's findings has it not occurred to counsel for appellant that the trial court believed Ward's testimony?

In this connection, see Mr. Friedman's testimony [R. pp. 190-191] which shows entry in Ward's partnership books giving him credit for this loan to the partnership. Friedman admits there was such an entry in the financial statement, Trustee's Exhibit 2.

(See Appendix No. 1, Quoting and Citing Ward's Testimony, With Reference to Exhibits.)

Also, testimony of other witnesses, including Esther Buhler. [R. p. 319.]

A bankrupt is not adjudged honest or dishonest by the nicety of his bookkeeping entries according to the highest standards of bookkeeping, as the Referee pointed out in his remarks to Mr. Triester that he (Triester) was making no distinction between a false statement and an incorrect statement. [R. p. 219.]

The Finding No. V of the first specification of objecting is made a part of findings on specification of objection No. 3 and this, together with Finding No. III [R. pp. 64-65] in findings on specification of objection No. 3 are clearly supported by the evidence.

Specifications of Objections 4 and 5.

Findings of fact upon specification of objection Nos. 4 and 5 are in a way consolidated and will be presented together.

First: Finding No. V [R. pp. 61-63] of the first specification of objection is applicable to specifications of objection Nos. 4 and 5 and certain findings of specification No. 5 are applicable to specifications of objection No. 4.

Finding No. III of specifications of objection No. 5 is applicable to specification No. 4, and the facts are set forth in Appendix No. 2 hereto attached. [See also R. pp. 588-672.]

These findings tell a rather complete story and are supported by the evidence of Mr. Ward and Garibaldi, upon the subject as well as the following documentary evidence. See Bankrupt's Exhibits 21 to 27, inclusive.

It is significant to note that it was Mr. Bowers, the field auditor for U. S. Rubber, who set up the first Garibaldi entry in the financial statement, and U. S. Rubber most certainly knew what it was all about. The company was constantly after Mr. Ward to get such orders and commitments from important customers and it was good business to do so for it kept them from ordering their tires elsewhere. Also, if, as Mr. Stout said, U. S. Rubber counted Mr. Ward's tires on hand each month, the company certainly knew whether such a large order of tires had been delivered.

The Referee's findings above mentioned refutes the statement of appellant that neither of the Garibaldi nor Navajo Freight Lines orders were fictitious or that all of them had been factored. Again this finding is supported by Mr. Ward's testimony and by documentary

evidence. As a matter of fact, the transcript will disclose that counsel for appellant admitted in open court that the first Garibaldi order was not factored. It seems rather strange that he would now make such a statement and try to brand Mr. Ward as a crook and a liar when there is a total lack of evidence to support such unfounded assertions. In doing so counsel certainly is not expressing the views of the trustee, but rather the feelings of U. S. Rubber. It is obvious that the Referee believed Ward. It is true the Referee made some critical remarks about Ward's testimony before he got the whole story, including the Exhibits. But it is evident that the Referee followed Ward's testimony rather than Friedman's theory.

It was Mr. Ward, himself, in an affidavit filed in support of or in resistance to one of the many motions which brought to light the fact that the account of the County of Los Angeles had been paid and that his bookkeeping department had inadvertently failed to make an entry thereon. Ward discovered this when checking for other information and he immediately disclosed it to the Court.

We are not here contending that there were no errors. There are always many bookkeeping errors in a large business of this kind. What we do contend is that there were no intentional errors or fraudulent misrepresentations.

The evidence shows, without conflict, that Ward had a large business and over a period of time did in excess of $10,000.000.00 with U. S. Rubber. [R. p. 240.] That in the last 24 months his business with said Rubber Company was in excess of $700,000.00. Mr. Ward said [R. p. 245] that in 1950 he owed U. S. Rubber $110,000.00. He agreed to liquidate assets and reduce this amount to

$80,000.00 and then execute 40 serial notes for $2,000.00 each, payable one every 30 days, starting March 25, 1951.

Mr. Swartz of U. S. Rubber told Ward at the time that he was insolvent, so U. S. Rubber was fully aware of Ward's financial condition, with or without financial statements.

Mr. Ward frequently discussed with Mr. Stout his financial condition. He told Stout about the sale of the Seal Beach property in September, 1952 Mr. Stout admits the last time he talked with Ward about the Seal Beach property was in the fall of 1952. [R. p. 384.]

Mr. Ward did not personally make out the financial statements nor did he sign them. It was a mechanical operation that was done by the bookkeeping department. Not only were these statements furnished monthly, but a report of the sales progress was made by telephone every ten days. Mr. Ward did not see each statement before it was mailed.

In the recent case of *Household Finance Corporation v. Groscost,* 230 F. 2d 608, the Referee's findings that the Finance Company did not rely upon the financial statement was upheld by both the District Court and the Court of Appeals. In this case the Finance Company was found to have dealt with the bankrupts over a period of five years and the Court said that the Finance Company knew, or should have known, the financial condition of the bankrupts.

Here, in this case, U. S. Rubber had done an extensive business with Mr. Ward for a period of thirty years, running into many millions. Not only that, but U. S. Rubber's best auditors were turned loose in Mr. Ward's place of business and made a complete check of everything.

They had access to all records, both personal and partnership. Thereafter, according to Stout, they counted the tires each month and took a complete inventory. Mr. Ward gave them a telephone report every ten days as to the amount of sales. They did not have to have a financial statement to know what was going on, and if they did, their own auditor helped prepare those from Mr. Ward's own records.

Again we say that they knew as much about Ward's business as he did himself.

Fraudulent Intent Is an Essential Element and Must Be Established Before a Discharge Can Be Denied Under the Above Specifications.

Construction of Discharge Provisions.

"Statutory provisions regulating discharges are remedial in their nature. They should be construed liberally with the purpose of carrying into effect the legislative intent, and the grounds in opposition enumerated in Sec. 14c should not be extended by construction."

Collier on Bankruptcy, Vol. 1, 14th Ed., p. 1254.

Intent: Meaning of "False."

"It has been held that an intent to defraud is essential; the word 'false' means more than erroneous or untrue and imports an intention to deceive, and a materially false statement in writing must have been knowingly or intentionally untrue to bar a discharge. Intention to deceive is always material as an element of proof, and, by the weight of authority, such intent is an essential element. It must be shown that the bankrupt's alleged false statement in writing was

either knowingly false or made so recklessly as to warrant a finding that he acted fraudulently."

Collier on Bankruptcy, Vol. 1, 14th Ed., p. 1351.

See also:

International Harvester Co. of America v. Carlson, 217 Fed. 736;

In re Stafford, 226 Fed. 127;

Baash-Ross Tool Co. v. Stephens (9th Cir.), 73 F. 2d 902.

It is said in the case of *In re Boomgaarden,* 17 F. 2d 149 at 150:

"It must be kept in mind that the burden is upon the objecting creditor to prove that the bankrupt obtained money or property on credit upon a materially false statement, that the statement was in writing, *that it was made to the creditor for the purpose of obtaining credit,* that it was known to be false by the bankrupt, and that the creditor relied upon it when he parted with his property. Matter of Wolff, Bankrupt (D. C.), 7 Am. Bankr. Rep. (N. S.) 365, 11 F. (2d) 293; Bank of Monroe v. Gleason (C. C. A.), 7 Am. Bankr. Rep. (N. S.) 56, 9 F. 2d 520." (Emphasis ours.)

and in the case of *In re Sugarman,* 3 Fed. Supp. 502 at 504, the Court said:

"Statement will bar discharge if (a) property was obtained on credit thereby, (b) the statement was materially false, and (c) was made for the purpose of obtaining such property on credit. *Morimura, Arai & Co. v. Taback,* 279 U. S. 24, 49 S. Ct. 212, 73 L. Ed. 586."

In sustaining the fact that a business man has a right to rely upon his bookkeeper, the Court in the case of *In re Collins,* 157 Fed. 120, held, quoting from the syllabus:

> "A materially false statement in writing made by a bankrupt for the purpose of obtaining property on credit, to debar him from the right to a discharge under Bankr. Act. July 1, 1898, c. 541, Sec. 14b (3), 30 Stat. 550 (U. S. Comp. St. 1901, p. 3427), as amended by Act Feb. 5, 1903, c. 487, Sec. 4, 32 Stat. 797 (U. S. Comp. St. Supp. 1907, p. 1026) must have been either knowingly false or made so recklessly as to warrant a finding that he acted fraudulently. Such a statement of assets and liabilities, made by a merchant from his books and believed by him to be correct, will not warrant a denial of his discharge in bankruptcy, although it was in fact materially erroneous, by reason of the failure of his bookkeeper, through illness, to enter on the books certain liabilities which existed at the time the statement was made, and which were in consequence omitted therefrom."

In re Hatch, 43 F. 2d 378;

Tibbs v. Cater, 191 F. 2d 957;

In re Johnson, 215 Fed. 748;

In re Morgan, 267 Fed. 959;

International Shoe Co. v. Kahn, 22 F. 2d 131;

In re Parnell Lbr. Co., 107 Fed. Supp. 794.

See Dave Garibaldi's testimony beginning [R. p. 703]. See testimony beginning [R. p. 883].

See also Bankrupt's Exhibits 24, 25, 26 and 27.

See second page of Trustee's Exhibit 15 one-half way down page, opposite date of "12-8" shows Garibaldi Bros.

marked "paid." Another item of Garibaldi on Trustee's Exhibit 15 marked "paid."

The total of Garibaldi accounts marked "paid" are:

$4,697.20
2,226.04
7,045.82

$13,969.06

SPECIFICATIONS OF OBJECTION No. 11d.

Important Evidence Received at the Trial, Upon Which the Referee Relied, Is Found to Be Missing From the Printed Record.

Although appellant contends that the evidence received by the Referee compels a different finding, yet through inadvertence or otherwise, considerable important evidence, upon which the Referee relied in support of his findings, and more particularly upon the findings with reference to specifications of objections No. 11d and 12 is missing from the printed record.

The bankrupt has been financially unable to furnish his counsel with a copy of the transcript of the evidence taken at the trial, and during the course of the proceedings counsel has been compelled to secure information therefrom in much the same way that Lazarus secured his bread. We did our begging, however, from a gentleman not so elaborately dressed, but very kind and considerate.—The Referee permitted us to make examination of the original transcript. We have no immediate access to the transcript, but we do know that attorney, James B. Ogg, testified in behalf of the bankrupt to the effect that the bankrupt came to him for advice as to what he should do

with reference to the mail of the bankrupt, after the attachment of May 19th, and Mr. Ogg testified that he advised Mr. Ward, that in his opinion the only way the accounts receivable could be attached would be by serving a writ upon the debtor, and advised Mr. Ward to have his mail transferred to General Delivery. Mr. Ogg testified that he immediately informed Glenn Traugher, Chief Deputy of the Civil Department of the Sheriff's office that he had so advised Mr. Ward. This testimony appears at pages 4 to 11 in the volume of the transcript containing Ogg's testimony.

Testimony of Witnesses Also Produced by the Bankrupt Upon Specification of Objection No. 12 Is Missing From the Printed Record.

The bankrupt called as witnesses Richard Ward, John Vernon and others.

The testimony of these witnesses does not appear in the printed record although it is explanatory of certain property, including batteries which the objector contended were missing from the Ward inventory.

Not having the transcript of the evidence before us, we are now very suspicious of what additional important evidence may have been omitted from the record at the request of counsel for U. S. Rubber. We will not have sufficient time to examine into this before filing our brief.

Unless all such evidence is supplied in a printed record to this Honorable Court by appellant, we shall insist upon the dismissal of the appeal and take such other steps as we may deem advisable to protect the interest of the bankrupt.

We shall proceed with our argument upon the remaining specifications of error as though the record was complete.

The facts briefly stated are:

On May 19, 1953, at 11:00 A. M., the place of business of the bankrupt, known as C. V. Ward's Tire Sales at 2601 West Mission Road, Alhambra, California, was attached by U. S. Rubber Co., and a Sheriff's keeper was placed in custody. The bank accounts in the Bank of America at Alhambra, California, and the Motor Vehicles, were attached.

The instructions to the Sheriff did not direct the attachment of the accounts receivable, of the U. S. mail (if such was subject to attachment) [see testimony of Mr. Amio *re* mail at R. p. 1100] or of any property not in existence or available *at the time of the original levy.* The instructions make no mention of the operation of the bankrupt's business.

Mr. Ward testified that on May 19th, when the mail came in, his office processed it, the checks were put in the cash drawer and the Sheriff took possession of them. [R. p. 1062.] The following day he received the letter from Pasadena Finance Company which is marked herein as Bankrupt's Exhibit 52 which required the checks on assigned accounts mailed to them. Mr. Ward took this letter and showed it to the Sheriff's keeper, and the keeper stated to him, in effect [R. pp. 1063-1076] that he could not take anything that Mr. Ward had on his person or in his pocket, and told Ward if he met the mailman before he delivered the mail at the place of business and took it, it would not be under attachment and the Sheriff could

do nothing about it; that Ward would have a right to keep it.

Mr. Ward did not rest his right to so receive the mail upon what the keeper had told him, but sought and obtained the advice of his attorney, James B. Ogg, whom he had employed to represent him in this case.

Mr. Ogg advised Mr. Ward that in his opinion the only way the accounts receivable could be attached would be by serving a writ upon the debtor, and advised Mr. Ward to have his mail transferred to General Delivery. The attorney also informed Glenn Traughber, Chief Deputy of the Civil Department of the Sheriff's office, that he had so advised Mr. Ward.

Mr. Ward thereupon changed his mail to General Delivery and turned the checks upon the factored accounts over to the Pasadena Finance Company and the checks in payment of the free accounts were cashed by Mr. Ward and used by him to buy gas and oil for the service station and the money which he received from the operation of the service station (sale of gas and oil) was turned over to the Sheriff until such time as the gas and oil end of the service station was released outright to Mr. Ward.

The United States Mail Addressed to the Bankrupt Was Not Under Attachment, nor Could It Properly Be Attached. A Levy of Attachment Made by an Officer on Personal Property Which He Does Not See or Have in His Possession Is Void. Attachment Statutes Must Be Strictly Followed or No Rights Will Be Acquired Thereunder.

First.—Section 542, C. C. P., requires "instructions in writing, signed by the plaintiff or his attorney of record, *and containing a description of the property,*" (emphasis ours) be delivered to the Sheriff or other officer named in said Section.

No mention of the United States mail addressed to the bankrupt, checks, nor a description thereof was mentioned in the written instructions which are in evidence.

Second.—Since the remedy of attachment derives its existence entirely from the legislative enactment, it has the scope, and only the scope, which the Legislature has chosen to accord it. The rule of the law of attachment is to the effect that the provisions of the statute conferring the remedy must be strictly followed, or no rights will be acquired thereunder.

Ruskin v. Cheney, 25 Cal. App. 2d 753 at p. 755, Par. No. 1, and cases cited thereunder;

Alpha Stores, Ltd. v. You Bet Mining Co., 18 Cal. App. 2d 252, at 258.

Third.—"A levy of attachment made by an officer on personal property which he does not see or have in his possession is void."

Los Angeles Soap Company v. Bossen, 122 Cal. App. 237 at 241, Par. No. 3;

Herron v. Hughes, et al., 25 Cal. 555;

Taffts v. Manlove, 14 Cal. 47.

The case of *Los Angeles Soap Co. v. Bossen* above cited points out at page 242 that Section 542, Code of Civil Procedure provides: "Personal property capable of manual delivery, must be attached by taking it into custody."

Subdivision 6 of Section 542 provides the method, and the only method, to be used in the attachment of accounts receivable. *At the time the attachment herein was levied the checks which were later received through the mail by Mr. Ward were in the form of an account receivable.*

The Court, in the *Estate of Troy,* 1 Cal. App. 2d 732, said, paragraph 4, page 735:

> "When the realty was converted into cash this became personal property which was not in the hands of the executor when the attachment was levied. As an attachment applies only to debts existing at the time of the levy (*Norris v. Burgoyne,* 4 Cal. 409), the lien of the attachment could not cover after-acquired property. This has been the accepted rule in this state for so many years that we need not consider authorities from other jurisdictions which, while not holding directly to the contrary, might support the argument for a different rule."

The above, we submit, supports our contention that these checks which came through the mail after May 19th were in the form of accounts receivable at the time of the levy of the attachment, and could only be legally attached pursuant to subdivision 6 of Section 542, Code of Civil Procedure, and the attachment could not reach the checks, themselves.

The attaching creditor could acquire no greater rights than Mr. Ward had in the factored accounts—*Santens v. Los Angeles Finance Co.,* 91 Cal. App. 2d 197 at 201, paragraph No. 2, and Ward was clearly within his rights in turning these checks over to Pasadena Finance Co.

Subdivision 8 of Section 542 has reference to checks and drafts, etc., which *are in the possession of and payable to the defendant at the time of the levy of the attachment.* The testimony is to the effect that Mr. Ward placed in the cash drawer all checks, drafts, and moneys received on the day of attachment and that the Sheriff received the same.

It is obvious that moneys or checks coming into the hands of the bankrupt after the levy of the attachment on May 19th were not properly covered in the instructions to attach or under the attachment. The Sheriff, as we have already seen from the above cited cases, can only attach what he sees and takes into his possession.

If it was ever the intent of U. S. Rubber Co. to attach the accounts receivable, and we doubt very much if such was its intent, then it should have strictly complied with the provisions of subdivision 6 of Section 542, Code of Civil Procedure.

We therefore believe that the advice given by attorney Ogg was right; that the bankrupt believed it to be a

correct statement of the law and followed it, and in doing so he had no intent, fraudulent or otherwise, to hinder or delay any creditor.

Furthermore, the U. S. Rubber Co. benefited by the transaction, since all the money received from the free accounts was used by Mr. Ward to purchase gas and oil, and upon the sale of the gas and oil the money was turned over to the Sheriff's keeper for the benefit of U. S. Rubber Co. Thus, U. S. Rubber Co. acquired in this manner money which it could not have rightfully acquired under its instructions and attachment. This, it appears to us, clearly demonstrates no intent, or even the remotest thought upon the part of Mr. Ward to keep these funds away from the attaching creditor. He had these checks cashed and in use in the custody of the Sheriff before the Sheriff could possibly have cleared the checks.

The Sheriff, Even Had He Been so Instructed, Had No Right to Seize the Bankrupt's Mail Under the Writ of Attachment.

There is nothing in the attachment statutes, either express or implied, authorizing the Sheriff to take possession of mail of the attached defendant. We have searched for a California case upon this subject and have found none. There is, however, an early New York case cited in Code of Civil Procedure, West's Codes Annotated. It is *Hergman, et al. v. Dettleback, et al.,* 11 How. 46, where the Court in holding that the books and records of a partnership might be held by the Sheriff, also held that letters and correspondence are not among the papers authorized to be seized. The Court in this case said:

> "But the power of the sheriff, under the attachment, is limited to the right to *take* them only; and having

taken, he was required to *safely keep them.* (2 R. S. 3, Sec. 7.)

"The sheriff had not power or authority beyond that, except as directed by the officer who granted the warrant. (Vide, Sec. 8.)

"When, therefore, the deputy sheriff assumed to examine such books and papers, take copies of the business letters, look into the correspondence of the partners, or do any other act in relation to them, than simply to *keep them safely,* subject to the direction of the judge who allowed the process, he was guilty of an unpardonable abuse of his powers, and of the process of the court.

"It was usurping the exercise of a discretion which the statute reserved to the judge alone, and reserved to him, too, for reasons of the most obvious character. To tolerate such a proceeding would lead to the most gross abuses, and enable the process of attachment to be used for inquisitorial purposes, which, in its consequences, would be in derogation of the spirit of the Bill of Rights.

"It is evident, also, from the affidavits, that many papers, not contemplated by the statute, have been seized in this proceeding under color of the attachment.

"The statute provides that certain books and papers may be taken into possession under the process. (Vide, Sections 7, 8.)

"Letters and correspondence are not among those authorized to be taken.

"As the whole proceeding on the part of the deputy, in examining the books and papers, is grossly irregu-

lar, an order must be made, that the regular books of account of the firm, and its notes, policies of insurance, and all other securities and vouchers, be safely kept by the deputy sheriff, under lock and key, without power on the part of such deputy, or any other person, except the defendants, to look into or examine the same, except under the special order of the court, to be made on notice to the defendants.

"The defendants and their counsel to be at liberty, at all reasonable hours, to examine, or take copies or abstracts from them, in the presence of the deputy.

"All other papers, of every name and description, taken by such deputy, and all translations, or copies of such translations, if any, of the books, letters, vouchers or papers, must be delivered up forthwith to the defendants' attorneys; and to insure the same, such delivery must be made under an affidavit—to be made by such deputy, by the plaintiffs, and their attorneys and counsel—that, at the time of such delivery, such copies embrace every translation, or copy of such translation, or copy of such original which the deponent knows of, or believes, or has any reason to believe, exists; and the plaintiffs and their attorneys, agents and counsellors, are hereby restrained from in any way using such original books and papers, or using or disclosing the contents of such copies in any manner whatsoever, except by special order of the court.

"This order must be complied with forthwith, and is to be entered with costs of motion."

If U. S. Rubber Could Not or Did Not Attach All of the Bankrupt's Property, the Bankrupt Was Entitled to Make Reasonable Use of His Property Not Under Attachment, Without Being Subject to the Charge of "Hindering and Delaying Creditors."

No duty is imposed upon a defendant, when he has been served with a writ of attachment, to go out and gather up any part of his unattached property and surrender it to the sheriff, and no case can be found where such a duty is so imposed. Suppose, for example, that Mr. Ward had maintained a bank account in some other branch of the Bank of America other than those mentioned in the plaintiff's instructions. Could he be properly criticized for not making it known to the Sheriff, and could he be said to have hindered and delayed the attaching creditor because he may have drawn such money out of the bank and used it for some proper business purpose? The answer obviously must be "No."

Ward Believed and Followed the Advice of His Attorney, and Since He Was Advised and Believed That the Attachment Did Not Cover the Checks Coming Through the Mail, There Was No Intent Upon His Part to Hinder or Delay the Attaching Creditor.

As we have heretofore pointed out, a defendant who has had certain of his property attached has a right to use his unattached property for proper business purposes, without subjecting himself to the charge of hindering and delaying the attaching creditor. Clients usually go to their counsel and seek advice, and pay for it, for the purpose of following it and keeping out of trouble. We submit that there is every reason to believe that Mr. Ward

sought this advice in good faith, believed his counsel when he was advised that the mail could not be attached, and if he believed it was not under attachment, then there is no basis for holding that he did anything with intent to hinder and delay under the facts in this case.

It must be remembered that it was the Sheriff's keeper who first suggested to Mr. Ward that he get the mail before it reached the place of business, and had he been determined to take it regardless of the legal consequences, he did not need the advice of the attorney whom he was paying to guide him aright. He could do the improper thing without the advice of counsel.

Is it any wonder that the bankrupt, an ordinary layman, needed legal advice to determine whether he was free to deal with the checks coming through the mail when this same question bothers the Court and counsel?

As said by the Court, *In re Wyche,* 51 Fed. Supp. 825, at 828:

> "I have been unable to find the authority for seizing and selling a bond of this series, which is U.S. Savings Bond, Series 'E'. Since both lawyers and the Court itself are unable to cite authority for seizing and selling bonds of this character, it must follow that a layman cannot be charged with bad faith in concluding that a bond that is not transferable is exempt. Even though the bonds are assets and should have been surrendered, it would not be a sufficient offense to deny a bankrupt a discharge, if he honestly thought the bonds were exempt and not an asset. He stated that he thought that since

his wife's name was written on the bonds they were payable to her. The conduct of the bankrupt in this matter is not reprehensible and he should not be denied a discharge."

Had the bankrupt used the money which he received through the mail for some fraudulent, questionable or unbusinesslike purpose, possibly an intent to hinder and delay might be inferred from his acts, but when he uses it in his business where it promptly flows into the Sheriff's keeper's hands, a contrary conclusion must follow. Such conclusion is buttressed by the fact that he fully and fairly disclosed the facts to his counsel, sought the advice of counsel and acted thereon in a fair and upright manner and in a way entirely free from an evil or corrupt mind.

In Order to Prevail Under This Specification of Objection, There Must Be More Than a Mere Intent to Hinder and Delay a Creditor.

The bankrupt to be denied a discharge under this subsection of the Bankruptcy Act, must have within the specified time, *transferred, removed, destroyed,* or *concealed* (or permitted these things to be done) his property "with intent to hinder, delay, or defraud his creditors."

Section 1(7) of the Bankruptcy Act defines "conceal," and subdivision 30 of Section 1 of the Act defines "Transfer." We observe no definition of the words "removed" or "destroyed," but I think we can readily agree that no property was destroyed. It was all preserved. We can likewise agree that it was not concealed, for it was done openly, avowedly and with the knowledge of the Chief Civil Deputy Sheriff [Tr. July 13, p. 4, line 15, to p. 5, line 4], and of the keeper. [Tr. June 12, p. 13, line 22, to p. 14, line 26.] Furthermore, the money received from

the free checks coming through the mail was used to purchase gas and oil and an accounting kept thereof and the Sheriff took possession of the funds received from the sale of this gas and oil. [Tr. June 12, p. 78, lines 7-11; p. 79, lines 18-20.]

Volume 1, Collier on Bankruptcy, 14th Ed., page 414 says:

> "'Conceal,' according to Sec. 1 (7), *supra,* Par. 1.07, 'shall include secrete, falsify, and mutilate.' This definition obviously does not attempt to be exclusive. Hence the interpretation heretofore given to 'conceal' is necessary to discover its meaning. The word 'conceal' is construed to mean to hide or withdraw from observation, to carry or keep from sight, to prevent discovery of, or to withhold knowledge of the existence, ownership, or location of property. Thus, where a partner refused to pay firm creditors or to divulge where he was keeping firm funds, this constituted a firm act of bankruptcy. Some older decisions held it to be a concealment where the debtor procured an attachment to issue upon a fictitious debt in order to prevent a creditor from attaching his property. *But where a debtor converted his property into cash intending in good faith to invest it later in tangible property for business purposes, this did not constitute a concealment which could be treated as an act of bankruptcy.* (Emphasis ours.) . . . And proof of concealment requires something more than a mere failure to volunteer information to creditors."

See also *Continental Bank & Trust Co. of New York v. Winter,* 153 F. 2d 397 at 399, paragraphs 3-5. "Proof of concealment, however, requires something more than a mere failure to volunteer information to creditors."

Collier likewise defines "Transfer" and "Removal" and says that "Removal" "signifies an actual or physical change in the position or locality of property of the debtor resulting in a depletion of the debtor's estate."

1 Collier on Bankruptcy, p. 415.

See:

In re McGraw, 254 Fed. Supp. 442.

Mr. Ward did not transfer any of this property. He received the cash on the free checks which were made payable to him, and he purchased gas and oil with it and the attaching creditor received the benefits thereof.

We Respectfully Contend, Notwithstanding the Expression of the Trial Court to the Contrary, That the Act of the Bankrupt Here Complained of Must Have Been Done With Fraudulent Intent Before His Discharge Can Be Denied.

Volume 1, Collier on Bankruptcy, 14th Ed., page 1360, paragraph 14, 47, under the heading "Intent" says:

> "In order to justify a refusal of discharge under Sec. 14c(4), it must be shown that the acts complained of were done with an intent to hinder, delay, or defraud his creditors. This intent, moreover, must be an actual fraudulent intent as distinguished from constructive intent."

and cites a long line of cases in support of the statement.

The 9th Circuit Court in the case of *Harris v. Baker,* 86 F. 2d 937 at 937-938, said:

> "Intent to defraud is the basic ingredient of the bankrupt's acts. Good faith must emphasize his act in dealing with his property."

And, again, the Court says:

> "It is the evil mind against which the bar is placed so as to guard against repetition, as well as give creditors a hold on the future activities of the bankrupt."

This was an objection under section 14c(4) Bankruptcy Act.

In re Wolf, 165 F. 2d 707 at 710, the Court says, "To bar the bankrupt's discharge there must be an actual fraudulent intent (Collier on Bankruptcy (14th Ed) page 1360)." This case involved a discharge under Section 14c(4) of the Bankruptcy Act.

Judge Kaufman of the New York District Court, in the case of *In re Nemerov,* 134 Fed. Supp. 678, in passing upon a similar objection says:

> "It is clear that there must be actual intent to defraud; constructive intent is not sufficient to bar discharge. This view is buttressed by a comparison of the discharge provisions of the Bankruptcy Act with the provisions of that Act relating to setting aside conveyances which are deemed fraudulent as to creditors. The conveyance section states that a transfer is fraudulent 'if made or incurred without fair consideration by a debtor who is or will be thereby rendered insolvent, *without regard to his actual intent.*' The provision relating to discharge contains no such specific and conclusive language. It is, therefore, reasonable to assume that if Congress had intended to foreclose proof of intent in dealing with fraudulent transfers which bar discharge, it would have used more specific language."

Suffice it to say that there are many cases of similar import.

The Cases Cited and Heretofore Relied Upon by Counsel for the Objector Are Mostly Cases Involving an Act of Bankruptcy, Instead of an Objection to a Discharge.

A careful reading of *In re Hughes,* 184 Fed. Supp. 872, heretofore cited by counsel for the objector, demonstrates this point, notwithstanding counsel's intimation that this case involved a discharge.

In the case of *In re Perlmutter,* 256 Fed. Supp. 860, cited by opposing counsel, there was involved a *consummated* fraudulent withdrawal of money by the bankrupt, who told an unbelievable story with reference to paying off a gambling debt.

In re Lampros, Inc., 18 F. 2d 633, was another case dealing with a transfer of property in an involuntary bankruptcy proceeding, as distinguished from an objection to a discharge.

Just why counsel cites *Duggins v. Heffran,* 128 F. 2d 546, is hard to understand. The writer of this brief was the Referee before whom this case was tried. There was an abundance of evidence showing a fraudulent intent. [See the findings.]

Duggins had deeded to his then secretary-sweetheart some property, without consideration, and clearly with fraudulent intent to hinder and delay his creditors.

I held that this property was conveyed without consideration and with intent to hinder, delay and defraud his creditors, and held it to be an asset of the estate. The Court of Appeal reversed this ruling solely upon the ground that the action was barred by the statutes of limitations in 115 F. 2d 519. However, the Court in 128

F. 2d 546 upheld my order denying the bankrupt's discharge.

A careful reading of other cases cited by counsel for the objector will reveal they are not in point.

Advice of Counsel as a Defense.

The case of *Fisk v. Commissioner of Internal Revenue,* 203 F. 2d 358, involves the question of whether a taxpayer can be penalized for filing a belated return when acting upon the advice of counsel. The Court at page 359 says:

> "As pointed out by the Second Circuit in *Haywood Lumber & Mining Co., supra* (178 F. 2d 771), 'To impute to the taxpayer the mistakes of his consultant would be to penalize him for consulting an expert; for if he must take the benefit of his counsel's or accountant's advice cum onere, then he must be held to a standard of care which is not his own and one which, in most cases, would be far higher than that exacted of a layman.' "

Then the Court further says at page 360:

> "We adhere to the rule stated in *Haywood Lumber & Mining Co., supra,* that as a matter of law reasonable cause was shown in this case. This rule, we hold, applies to the filing of tax returns as well as to reliance upon technical advice in complicated legal matters. We think this conclusion is in accord with the principle declared by the Supreme Court that the penalties under the revenue laws were designed to be imposed upon conduct 'which is intentional, or knowing, or voluntary, as distinguished from accidental.' *United States v. Murdock,* 290 U. S. 389, 394, 54 S. Ct. 223, 225, 78 L. Ed. 381. 'It is not the purpose

of the law to penalize . . . innocent errors made despite the exercise of reasonable care.' *Spies v. United States,* 317 U. S. 492, 496, 63 S. Ct. 364, 367, 87 L. Ed. 418."

In the case of *Dilworth v. Boothe,* 69 F. 2d 621 at 623, the Court held that acts done upon the advice of counsel was a defense where property had been omitted from bankruptcy scheduled.

To the same effect are:

Thompson v. Eck, 149 F. 2d 631 at 633;
Merritt v. Peters (9 Cir.), 28 F. 2d 679.

The Court points out in this case that the client has a right to act upon the advice of counsel upon questions of law, as distinguished from questions of fact, which he should know, where he fully and fairly states the facts to his attorney and acts upon advice as to matters of law.

Here, Mr. Ward was given advice upon a question of law, and followed the advice given.

There are many other cases of similar import, but we do not deem it necessary to burden the Court with further citations.

Summary.

Under the discussion of the lack of authority of the Sheriff to receive the mail, we neglected to point out that when Mr. Amio testified on June 12th that he had no ruling whereby he could open the mail [R. pp. 1100-1101] said: "We had no control over the mail," Mr. Ward is not required to do any acts for the Sheriff which the Sheriff was without authority to do, although Mr. Ward in effect did so by cashing the free checks and putting the money into the business where the Sheriff did get it.

SPECIFICATION OF OBJECTION No. 12.

The Referee found that each and every allegation contained in the twelfth objection, as amended, is untrue, and found that it is not true that the bankrupt failed to explain satisfactorily a loss of assets and a deficiency of assets to meet his liabilities.

There were volumes of testimony taken over days and weeks of time upon this particular objection. [See beginning R. p. 438.] As a matter of fact, the Referee considered all material evidence theretofore offered, upon this objection. This is another reason why none of the evidence should have been omitted from the Record. At first he ruled against the bankrupt, and then again. But finally the bankrupt presented affidavits and photostat copies of invoices and records which could not be disputed and the Referee re-opened the objection for further evidence. [R. p. 813.] The bankrupt was able to produce evidence and records which convinced the Referee that he was wrong in the first instance.

This was not the only objection which the Referee reopened for further hearing. He twice permitted the objector to re-open and amend his specifications of objection upon a number of the counts, but each time, after further hearing, refused to change his prior ruling.

The fact that the Referee did grant further hearings to both sides shows his extreme fairness and his desire to arrive at the correct answer.

It is the duty of appellant here to point out from the entire record wherein the Referee was wrong in his ruling, and if there is evidence to sustain his findings, the Court, under General Order 47, is required to sustain the findings. The mere citation of one bit of evidence is no in-

dication that the Referee accepted it, when there is other evidence to the contrary.

Certainly, the appellant cannot, by simply referring to small bits of evidence, establish the fact that the Referee's findings are "clearly erroneous."

Mr. Ward's testimony, found throughout the record, both oral and documentary, was believed by the Referee and accepted as a satisfactory explanation. The same is true with reference to the bankrupt's explanation of the tires, batteries and other items of equipment.

It is equally clear that Mr. Friedman's testimony and theories were rejected by the Referee, and rightly so. No doubt the fact that Mr. Friedman changed his figures and counts of tires and batteries several times (each time Mr. Ward would confront him with different documents and facts) caused the Court to come to the conclusion that Mr. Friedman was prejudiced in favor of his employer, U. S. Rubber, and that he did not know what he was talking about.

We do not believe the Referee was about to deprive an honest and upright business man of his discharge upon such wavering testimony.

The Objection Made Under Specification No. 12 Is Easy to Charge and Hard to Disprove.

Especially is this true where there has been a large volume of business by the bankrupt, followed by an operation by the Sheriff and then by an assignee.

The average businessman would have been completely lost if faced with a charge of this kind, for where there is a large volume of business and a large number of employees running it, there are always errors in bookkeeping

and shortages in inventory even under the most honest operations.

Fortunately, Mr. Ward had worked long enough with U. S. Rubber to understand their secret ways of arriving at a profit. During the trial, I believe it was the Referee who suggested that it was a peculiar business that could sell a tire at a price under cost and still make a profit.

Ward knew that the figures which Mr. Friedman kept coming up with were incorrect and he kept digging into the records and finding the correct answers. This took time and a diligent effort.

The bulk of the testimony directly upon this Specification came from Ward and Friedman. Ward prevailed. Friedman's explanations simply were not acceptable to the Referee who knows accounting himself. The Referee was more concerned with honesty than with the requirements of the fine details of accounting.

When counsel for the appellant cites bits of Friedman's testimony in support of his charge of error on the part of the Referee, he overlooks the fact that the Referee has the same right to accept the bankrupt's testimony, if believed, as he does that of an auditor hired and paid by U. S. Rubber.

The very fact that Mr. Friedman tried to make a big issue out of the Navajo Frieght Lines transaction, where it ordered 36 tires of a certain kind and later decided it wanted 30 tires of another kind and canceled the first order and Mr. Ward reversed the first sale so as to balance his books, would cause anyone to wonder why a C.P.A. would try to make an issue of such a transaction without first going to someone who knew and could explain a very simple transaction. [See Record beginning at p. 1206.] (Also App. 2.)

When Mr. Ward changed his factoring arrangement on the Garibaldi account from Pasadena Finance to Atlas Factors and took Atlas Fatcors' money over and paid Pasadena Finance off, just as one would if he changed the loan on his home from Mutual Savings to Federal Savings, Mr. Friedman picked this up and called it a double factoring, apparently without making inquiries from someone who would know and could explain a simple business transaction.

This is the type of a witness counsel for appellant asks this Honorable Court to follow, notwithstanding the fact that the Referee who saw him on the witness stand day after day over a three-year period, could not and did not accept his theories and explanations.

This Issue Was First Approached From the Dollar and Cents Point of View and Later by Count of Articles.

It is apparent from the record of this proceeding that prior to March 1, 1955, this issue was approached by the accounting angle with emphasis upon the dollar and cents point of view rather than the number of units unaccounted for.

Therefore, when the question of the number of missing units arose on March 1, 1955 (in the battery department), we overlooked the fact that four of the batteries in question were purchased prior to February 28, 1953, as we clearly demonstrated later by producing the invoice. Mr. Ward at the time did not have before him the information regarding the sale of four additional batteries as subsequently shown in Ward's affidavit in support of motion to re-open the case for further hearing.

Furthermore, Mr. Ward did not have before him or know the information subsequently given by his son and

James Samp in an affidavit form in support of the motion to re-open which accounts for 10 additional batteries. This accounts for fourteen of the missing batteries, and also shows that four more of the batteries alleged to be missing were erroneously counted as purchases after March 1, 1953, when in fact they were purchased prior to February 28, 1953, and were in the February 28th inventory. The sales by the assignee of batteries in the sum of $36.00 also shows sales of other batteries without giving the number. This is but a few of the accounted for items, but explains why the Court re-opened this count for further hearing after ruling adversely to the bankrupt.

When you have been proceeding from the dollar point of view and suddenly jump to an item by item count, it leads to confusion and, if the witness has not previously refreshed his memory from records where he has been doing a large volume of business, it is easy to become confused.

This demonstrates how difficult it is to account for every little article in the shop. Mr. Friedman also made concessions in his previous testimony and 92 of the 96 new batteries were finally accounted for.

In this connection, the case of *In re Horwitz,* 92 F. 2d 632, is very much in point. The Court at page 633 says:

> "The proof upon the second specification is of no more satisfactory character. This objection is grounded upon the fact that there is a discrepancy of some $19,000 between a financial statement made by the bankrupt in May, 1935, and his statement of assets and liabilities contained in his schedules, some four and a half months later. In other words, there is no direct evidence that the debtor has concealed

any of his property, or that the apparent deficiency is one in fact or, if real, was caused by any illegal act upon his part.

"Approximately $5,500 of this difference is due, according to the undisputed evidence, to uncollectible accounts receivable or bad debts. The evidence indicates rather clearly that the business of jobbing dresses is sharply controlled by the seasons; that during the period in question bad weather interfered with sales; that in order to dispose of his merchandise the bankrupt was forced to sell at a loss; that his creditors were pushing him; that he gave them post-dated checks and took substantial losses on sales, due to the unseasonable weather, in order to procure funds to meet the checks as they matured. He testified that his purchases totaled $48,000 in 1935, and his sales $52,000, but that his expenses and losses were approximately $21,000.

"If this testimony be true, the debtor should not be denied his discharge because of an alleged unexplained discrepancy. It is argued that the circumstances are such as to destroy his credibility, but the referee, before whom he testified and who had the opportunity of observing him upon the witness stand, concluded that he had made a reasonable explanation and that the specifications should not be sustained, saying that no adequate or substantial proof had been submitted.

"We have examined the evidence and we are of the opinion that his conclusion was correct, and, there being an absence of clear proof sustained the objections, that the discharge should be granted. Accord-

ingly, the order of the District Court is reversed, with directions to proceed in accord with this decision."

There is a total lack of evidence—not even a suspicion—that Mr. Ward took or concealed any of the property of the bankrupt estate. From the evidence we suspicion no one. But, also, from the evidence, it could be argued with as much force that the assignee or the Sheriff's force or both were responsible for the shortage. They were the last in possession.

It must be remembered that Mr. Ward was very much in business when U. S. Rubber clamped down with an attachment. Mr. Ward was not expecting or contemplating such action. He had given U. S. Rubber good checks for its May, 1953, payments and had no reason to believe that U. S. Rubber would not accept them. If Ward had been given any forewarning of this attachment action, then there might be some reason to suspect him of removal of some of the items. But he was running a business which he thought and believed would succeed. He had been able to meet all his obligations with U. S. Rubber and his other creditors. Certainly he was not going to steal from himself.

Therefore, objector's contentions just do not make good sense.

Answer to Appellant's Brief Under "A" of Argument. Page 5 Brief.

We have not heretofore made particular reference to appellant's brief. We see very little therein that really needs a reply in face of the volume of evidence which fully supports the finding of the Court. We have made reference by page to most of this evidence. It would

be too burdensome and an unending task to cite each answer or document which supports the Referee's finding.—The Referee expressed his views [R. pp. 405-1225] which covered the first five specifications of objections. The Referee again emphasizes the difference [R. p. 1226] between an incorrect and a false statement. He also calls attention to the fact [R. p. 1226] that this system of bookkeeping was suggested, if not put into effect, by U. S. Rubber; that whatever errors appeared [R. p. 1227] were not intentional errors. Certainly no burden was placed upon the objector not contemplated by the Bankruptcy Act. The trial court followed the evidence which he believed.

The effect of the warning, to which counsel refers, the Referee gave Ward [R. pp. 478, 479, 484] was not to volunteer information [see R. p. 484], where the Referee says:

> "You are so filled with your side of the case that you are taking advantage of every opportunity to try to get it across."

This could not be construed as an indication of disbelief of the witness.

The Referee Was Misled by Counsel for U. S. Rubber for a While Into Believing That Mr. Ward Had Factored the First Sale to Garibaldi [R. p. 759] and Was at First Led to Believe That There Had Been a Double Factoring as Distinguished From a Change in the Factoring Account, From One Financing Company to Another.

Again our Appendix No. 2 explains this situation. And while the court expressed itself in a certain way upon the Seal Beach property [R. pp. 760-761] and upon the battery evidence [R. p. 808] it later received evidence which

influenced and justified the findings subsequently made. [See cross-examination beginning R. p. 858.]

The bankrupt was denied an opportunity to explain. [R. pp. 870-871.]

Subsequently, however, when the court fully understood the true facts, its findings were entirely different. [See Examination beginning R. p. 691; and particularly pp. 694-696.]

It is one thing for counsel for U. S. Rubber to make the assertion that the bankrupt lied and quite another to point out such evidence supported by a finding of the court. I have used the expression "counsel for the U. S. Rubber" advisedly, for I know that any counsel representing the true views of the trustee in bankruptcy would make no such statement.

Because the bankrupt said [R. p. 646] that the Garibaldi account was the only one of its kind that he *recalled* counsel for appellant thinks he has the bankrupt branded as a liar (see p. 8, Br.), because the bankrupt later happened to recall other accounts [R. p. 895] of a kindred nature.

Answer to Appellant's Argument "B," Page 8 Brief.

It appears that we have already made a rather complete answer to the contention here made. The brief of appellant at bottom of page 9 says:

"The Referee concluded that U. S. Rubber had not relied upon the item of falsity," with respect to bankrupt's home. As we read these findings, the Referee did not find this to be false, although he did find a lack of reliance thereon. We have heretofore pointed out that the bankrupt told Swartz that the home was held in joint tenancy, and this testimony is not denied.

We again submit that the bankrupt bore any and all burdens of proof required of him under the law.

The Referee refused to find that the financial statements in question were intentionally false. He found to the contrary. He also found U. S. Rubber did not rely thereon, the statements of counsel (Br. p. 11) to the contrary notwithstanding.

The statement of the Referee [R. p. 410]; and quoted (App. Br. p. 11) was made early in the proceedings. From the court's findings, it is obvious that it came to a different conclusion, just as it did on other issues after hearing other evidence.

The effect of the court's Finding No. III [R. pp. 64-65] is to the legal effect that while the statement there mentioned was incorrect, it was not intentionally false. We have heretofore called attention to evidence showing Ward told Stout of the sale of the Seal Beach property in September, 1952, and Stout admitted he had not talked with Ward about this property since the fall of 1952. This is a strong indication that Stout knew of the sale.

We have also heretofore pointed out that the Referee distinguished between incorrect methods of account and false statements.

Mr. Freidman seemed to be unable to distinguish between improper methods of accounting, according to his ideas, and an intentional false statement.

Again (p. 13, Br.) counsel for appellant makes a misleading statement in respect to quoting the finding, through his failure to quote the contents of the entire finding. Neither does counsel distinguish between a statement of the court made in the early stages of the trial and the finding of the court which was finally adopted by the court in its ultimate decision.

The last paragraph of Finding III [R. p. 65] could very well have been, and doubtless was, made upon the strength of Ward's testimony to the effect that he had informed Stout in September, 1952, that the Seal Beach lot had been sold, coupled with Stout's testimony that he had not discussed this property with Ward since the fall of 1952. The statement which the trial court made during the trial (App. Br. p. 13) was made before its attention had been called to the above testimony which the Referee, at first, had overlooked.

The trial court was not bound to follow the inference of Stout, and it was only an inference, that he relied upon the financial statements in extending credit, and especially when there were convincing facts and circumstances showing that he did not so rely. One of such circumstances being the requirement that the inventory be counted on the 20th of each and every month, another, the fact that Swartz knew Ward was insolvent back in 1951. U. S. Rubber was interested in what could be accomplished by future sales and not what Ward's worth might be. They had already told him that he was insolvent.

The Court's Findings Upon Objections Nos. 4 and 5 Are Fully Supported by the Evidence.

We have already explained the situation covered in these findings in Appendix 2, by disclosing that *there was no factoring of the first Garibaldi invoice,* and there was no double factoring but rather a transfer of an account from one factor to another.

Mr. Treister, himself, admitted during the trial that the first Garibaldi invoice was not factored.

The evidence shows that it was Mr. Bowers, U. S. Rubber's auditor, who directed how the first Garibaldi invoice should be set up on the financial statements after he was informed as to the nature of the transaction. [See Find. No. III, R. pp. 68-69.]

Ward's testimony is to the same effect as shown in Appendix No. 2, as to the Navajo Freight Lines invoices, and shows that U. S. Rubber was fully advised thereof. The court's findings are supported by the testimony of Ward, Garibaldi, Adrainse, and by documentary evidence.

There was an unintentional error in the account of Los Angeles County which was explained by Mr. Ward and whose testimony was adopted in the court's findings. [R. p. 70.]

There Was No Error in the Findings of the Referee Upon Specifications of Objection No. 12, or in the Court's Order Reopening the Case for the Taking of Further Evidence.

There is a great volume of testimony, both oral and documentary, for and against the question of the ability of the bankrupt to account for losses of assets. There is sufficient conflict in this testimony that the decision of the court thereon should not be disturbed. It is purely a question of which evidence the court accepted as true. It finally accepted the explanation of the bankrupt as correct rather than the theories of Mr. Friedman, which were based upon his ideas of ideal methods of accounting. We have covered this question quite thoroughly in our brief before we began commenting upon the remarks made in appellant's brief.

The Right of the Referee to Reopen the Hearing for the Taking of Further Evidence Was Purely Within the Discretion of the Referee.

Furthermore, the motion made on April 7, 1955 (App. Br. p. 21), was supported by affidavits and documentary evidence. [R. p. 813.] Such affidavits and documentary evidence are not before this court in the record, and, therefore, this Honorable Court is in no position to pass upon the correctness of the court's ruling in the absence of this evidence.

The Court Properly Ruled That the Bankrupt Did Not Remove or Conceal His Assets With Intent to Hinder or Delay His Creditors.

This question has been covered fully hereinabove and we shall not repeat.

As to the court's comments (App. Br. p. 23) we only need to call attention to the court's memorandum of opinion [R. p. 50] which was rendered subsequent to the remarks cited in appellant's brief, and to the court's findings made much later. [R. p. 71.]

The word "preference" is used by appellant at bottom of page 23 of its brief, but counsel has cleverly avoided the use of the words "voidable preference." Obviously, the finance company held a valid assignment of these accounts and were entitled to the proceeds thereof.

All moneys received through the mail were used for one of two purposes. 1st—The finance company got the checks to pay the accounts which had been assigned to it. 2nd—Ward purchased gas and oil with the balance, sold the gas and oil from such sale for the benefit of the attaching creditor.

No one was injured in any way and there was no intent to injure, hinder or delay any creditor within the purview of the law.

The Referee spent days upon days and weeks upon weeks listening to all the evidence over a period of three years. He granted rehearings to both sides and patiently listened to further evidence from both sides. He personally saw, and participated in the examination of the witnesses. He studied the volumes of documentary evidence and arrived at his decision.

There is ample evidence, produced by the bankrupt himself, to sustain the findings. This should eliminate appellant's contention that the Referee placed the entire burden of proof upon the trustee. We respectfully submit that the findings and orders of the Referee should be sustained.

Respectfuly submitted,

UTLEY & HOUCK,

By ERNEST R. UTLEY,

Attorneys for the Bankrupt.

APPENDIX NO. 1.

Bankrupt's Case.

Clair V. Ward was called to the stand in his own behalf, and testified [R. pp. 234-239] that he had done business with the U. S. Rubber Company since 1923; [R. pp. 105-166]; that the nature of his business was the sale of automobile tires over the San Gabriel Valley, and that the volume of business that he did with the U. S. Rubber Company over the period of time was in excess of $10,000.000.00; [R. p. 240]; that in the last twenty-four months his business with said Rubber Company was in excess of $700,000.00. That during the entire period he gave them monthly financial statements. The partnership business was organized in the latter part of 1947, but not actually set up until 1948. That his financial position first became involved in the first part of 1950 due to the collapse of the television market at that time. [R. pp. 241 and 514.] In the first part of 1951 (January or February) the comptroller of U. S. Rubber Company visited Ward. His name was Mr. Swartz and he came here from New York. He brought with him Charley Ostrom, the co-ordinator of sales and finance to check my account because they felt that it was in a financial situation that they wanted to make an appraisal of it. I did not know in advance that they were coming, and when they arrived, they came to my office and asked for an opportunity to make a thorough examination into my assets and liabilities and all of my books and records, and they remained in my office for six or seven days, personally examining all of the available books and records which were all there in my office at the time. [R. p. 242.] "I made every record available to them and I instructed my employees to make any and all records available to

them at that time." During that period of time Ward had discussions with Swartz, and Ward told him his home was in joint tenancy. [R. p. 243.]

After several conferences with Swartz and Ostrom [R. p. 244], it was decided that I was to dispose of all my personal assets, with the exception *of my home and furniture,* in an orderly way and not to cause a distress sale, and to *put the money into the business.* The Seal Beach property was very definitely discussed. "I agreed with Mr. Swartz that I would liquidate the Seal Beach property at the earliest opportunity, without causing a distress sale, and realize the maximum amount from it." Mr. Swartz insisted upon it. He demanded that I dispose of all liquid assets and use the money as working capital.

At that time, I owed U. S. Rubber Company approximately $110,000.00. [R. p. 245.]

> "We had our last conference at the Ambassador Hotel on a Sunday morning, Mr. Swartz, Mr. Ostrom, Mr. Walsh, who was the Pacific Coast manager of U. S. Rubber Company, and Mr. Harry Oliver, who is now general sales manager of the company at New York, was the district manager in Los Angeles at the time. The committee agreed that if I would agree to dispose of all the liquid assets that I had, with the exception of my home, and would pay off my account down to a net amount of $80,000, that they would extend to me 40 serial notes of $2,000 each, with interest at six per cent, payable one every 30 days, starting March 25, 1951. I agreed to that program and told them I would liquidate the Seal Beach property at the earliest opportunity. I immediately listed it with two brokers in Seal Beach. I did not have an adequate offer on it until Sep-

tember of the following year, which I felt was a reasonable price in relationship to the value of the property. I exchanged it then for another piece of property and received $3,250 net in exchange." [R. p. 245.]

Ward's insolvent condition was mentioned by Swartz.

"Mr. Swartz called my attention to the fact that I was actually insolvent at the time and they were very doubtful as to whether I could go forward and liquidate my business or carry on my business, and that whether they should liquidate it at that time or work forward with me on it was a decision that they had to make after a thorough examination of all of the books and records, attacking the background apparently of my ability to carry on for the company. Apparently they decided that I could carry on and I had an opportunity to go forward and pay off my indebtedness, not only to the United States Rubber Company but to all the other creditors." [R. p. 246.]

"He said I was insolvent at that time and it was questionable in his mind whether I could make the grade or not. He said, 'I made a projection of a one-year period, showing the total sales and cost of sales, the expense of sales, and the cash position in each 30-day period that we would be operating in.' He subsequently sent me a copy of the projection after his return to New York." [R. p. 247.]

The document in my hand is a projection of the sales and expenses and the cost of sales for the period of the year 1951.

> "Immediately upon the receipt of that schedule or immediately upon the time that Mr. Swartz left to go back to New York, he placed Mr. Buck Bowers in charge of my office and he was representing the U. S. Rubber Company for a period of some 18 months, from that time on." [R. p. 247.]

Mr. Bowers was to supervise my operations. He was a field auditor for the U. S. Rubber Company. Mr. Bowers is the good looking gentleman with glasses, sitting in the court room. The projection above mentioned was offered in evidence as Bankrupt's Exhibit 1.

At about this time there was a complete change in my system of bookkeeping, set up by Buck Bowers. [R. p. 248.]

> "Mr. Bowers had full authority to direct the entire accounting system and used that authority in collaboration with my auditor, should I say, that he instructed my auditor." [R. p. 249.]

My auditor, Mr. Ross, died in August, 1952, I believe.

Bowers came into my office in the later part of February, 1951, immediately after Swartz and Ostrom returned to New York.

The financial statement of March 31, 1951, was the first one, and it was made by Buck Bowers. [R. p. 253.] Bowers also made out the April 30, 1951 statement. Bowers had full access to my books and records in preparing these statements. The May and June, 1951, statements are also in the handwriting of Bowers. Mr. Bowers gave me this folder where I kept my copies of the monthly statements. I had in my files in my office copies of substantially all financial statements which I had given.

Mr. Bowers was in charge of my books in early March, 1951, for 18 months.

The financial statements in the handwriting of Mr. Bowers are Bankrupt's Exhibit 8. [R. pp. 263-264.]

The Seal Beach property was sold in September, 1952, and the $3,250.00 cash received was first deposited in my personal bank account and then transferred to the partnership account. [R. p. 265.]

I transferred $1,000 on September 8, 1952, and $2,250 on September 17, 1952. (See Bankrupts Exhibits 9-10-11.)

I discussed with Mr. Harry Stout, the credit manager, in September, 1952, the fact that I had sold the Seal Beach property and had used the money to pay bills currently on that date. [R. p. 273.]

> "I did. Each month, when I reported to Mr. Stout as to the financial condition of my business and I carried my check into his office on the 15th day of each month, we sat down and had a discussion about the operation of the business and we discussed everything in detail that transpired the month before, in order that he might be thoroughly acquainted with all of the operations." [R. p. 274.]

Ward did not personally make out the monthly statements and did not sign them.

> "It was a mechanical operation that took place in accordance with instructions from U. S. Rubber Company that they receive not only monthly financial statements but a report of our sales progress every ten days by telephone." [R. p. 280.]

I directed my bookkeeping department to comply with the above request.

"The Referee: Let me interrupt here. [R. p. 280 to 283.] You said that you walked into Mr. Stout's office on the 15th day of each month with a check and you discussed the affairs of this business specifically and generally?

The Witness: That is true.

The Referee: Now, did you carry the statement there with you?

The Witness: I did not. The statement was due in their office between the 5th and 10th of the month, prior to the time that I made my monthly trek down to his office.

The Referee: And do you recall whether or not, within the last year of 18 months of your active business, in these discussions with Mr. Stout would there ever be one or more of these statements in evidence present at the time?

The Witness: Yes, I am certain that Mr. Stout had all of the statements at his disposal at all times and he always had the current statement in front of him, which we discussed.

The Referee: The point of the question is, in talking about your affairs, would either you or Mr. Stout or both of you actually refer to one or the other of the statements?

The Witness: We would, yes, sir.

The Referee: All right, go ahead.

Q. By Mr. Utley: Did he ever question the veracity of any of the statements? A. He never did, no, sir.

Q. In so far as you know, Mr. Ward, were all of the financial statements rendered to the U. S.

Rubber Company true and correct? A. To the best of my knowledge and belief, yes, sir.

Q. And did you intend them so to be? A. I most certainly did.

The Referee: I will ask you another question, then: The machinery was that the bookkeeper made out the statement from the records and sent it by mail, I assume?

The Witness: That is right.

The Referee: To the Los Angeles office of U. S. Rubber company?

The Witness: That is correct.

The Referee: Did you as a matter of practice see each statement before it left your office?

The Witness: I did not, no, sir.

The Referee: You mean the bookkeeper did not submit it to you before he mailed it?

The Witness: Not before he mailed it, no, sir.

The Referee: Well, what acquaintanceship or contact did you have with the monthly statements as they were prepared and sent out?

The Witness: I received a copy of the statement placed in this little black book you see here, your Honor.

The Referee: Where was that little black book usually kept in that period?

The Witness: That was kept in the office, in our safe. The bookkeeper, when we completed the month's operations, she would send United States Rubber Company a copy of the statement and place one copy in the book. At my leisure then, when I had an opportunity, I would sit down and analyze my copy.

The Referee: Did you have any regular time for doing it?

The Witness: No, I didn't, your Honor. Just as soon as I could get to that particular thing.

Cross-Examination

Mr. Swartz analyzed every asset I had. He personally went over my books, my records and my files and the details in my files and spent six or seven days in doing so. [R. pp. 284-285.] He took notes. Mr. Ostrom and Mr. Bowers were with him. The $51,200.70 items changed from time to time.

"Q. What was said about the Seal Beach property? A. In my final conference at the Ambassador Hotel, before the creditors' committee that was handling this matter, headed by Mr. Swartz, I was told that they would go along on the reorganization of my business with the $80,000 worth of notes, providing I would liquidate all of the personal assets that were available, and principally the Seal Beach property, at the earliest opportunity, and put that money into our working capital. And I was contacted from time to time, from month to month, as to what progress I was making in disposal of my property."

"In discussing the liquidation of my personal assets with the committee, it was estimated that we might obtain as much as $10,000.00 from the sale of personal assets, excluding my home and furniture. They did not demand that I liquidate the Cadillac car. They mainly wanted me to liquidate the Seal Beach and the Green Valley property.

In the early part of his assignment, Bowers spent full time at my place, [R. p. 291] which was in excess of six months full time. Bowers had authority to direct my office (bookkeeping) staff. [R. p. 292.] Mr. Bowers was in our place of business after September, 1952. He was there after February, 1953. [R. p. 293.]

"Q. Now, you stated that you told Mr. Stout in September of 1952 that you had sold the Seal Beach property, do you recall? A. That is correct, yes.

Q. Will you tell us where this conversation took place and who was present? A. It took place at the time I delivered my check to Mr. Stout in September, 1952, on or about September 15th, which was usually the time that I took it into his office, and we sat down and discussed the financial affairs again for the past month and I reminded Harry at the time as to the $2,250, he could advise New York that the Seal Beach property had been sold, that he had the $2,250 in the check which I brought in to him, and that no further proceeds could be applied from the sale of that one property.

Q. In other words, you were paying to the United States Rubber Company the proceeds of the sale of the Seal Beach property? A. Yes.

Q. Were you paying them anything additional for your note under the conditions which required you to pay them? A. I was not. I was paying the current accounts only at that time, which were the outstanding creditors' accounts.

Q. In other words, the proceeds of the Seal Beach property did not result in any additional payment to the United States Rubber Company? A. It did not.

Q. What did Mr. Stout say to you then? A. I don't recall the exact words of the conversation. We talked about the general financial affairs of the business. What related to that particular subject you will have to ask Mr. Stout.

Q. Did Mr. Stout indicate to you that any change had taken place on your personal assets section of your financial statement? A. He did not.

Q. Did you indicate to him that any change had taken place? A. We did not discuss the books at all at that time because the financial statement bearing the change was not in front of us." [R. p. 315.]

ESTHER BUHLER [Beginning R. p. 319]

I have known Mr. Ward about five and one-half years. I have known Mr. Bowers since September, 1951. I know Mr. Stout. I worked for Mr. Ward from July, 1948 to July, 1950, then I left his employ and came back again in September, 1951. When I came back, Mr. Bowers was in Mr. Ward's office and I worked under Mr. Bowers for about six months. I took my directions from Mr. Bowers. I prepared monthly financial statements. Mr. Bowers assisted me in the preparation of same, including the one for November, 1951.

The statements, Bankrupt's Exhibit 8, is in Mr. Bowers' handwriting.

Mr. Bernfeld stipulated that the money from the sale of the Seal Beach property went into the bank account.

Mr. Bowers told me how to prepare the monthly statements. "He sat down beside me and helped me put in the figures beside each amount." Mr. Ward would see a copy of the statement after it had been mailed.

CLAIR V. WARD, Transcript, Sept. 3, 1954.

OBJECTOR'S REBUTTAL EVIDENCE

"The Referee: Well, Mr. Ward, I want to ask you a question about something that bothers me considerably here.

The Witness: Yes.

The Referee: When you sold the Seal Beach lot, you realized a certain amount of cash, you put it in your personal account, and in two checks shortly thereafter that money, so you testify, was deposited in the business bank account. This was on February 28, 1953, the sale having occurred sometime in September, 1952. We find a most unique situation from an accounting or bookkeeping standpoint, that on February 28th, by means of a journal entry, the deposit of the sums of money represented by those two checks was officially recorded on the books. In the ordinary course of business, your bookkeeper, when you deposited the two checks in about the month of September, 1952, would have made an entry on the cash transaction records of the business. Apparently that was not done. Now, what do you know about it, if anything?

The Witness: Your Honor, I can explain that very clearly.

The Referee: All right.

The Witness: I deposited both deposits personally at the bank, at the time I was over to the bank in making normal deposits for the daily business deposits. I found that I required an additional thousand dollars on the first deposit to cover my outstanding checks. I deposited the $1,000 almost immediately after I received it.

I required an additional $2,250 when I sent the U. S. Rubber Company a check, and I deposited that at the bank and added that to the daily deposit, as the bank statement will show.

My bookkeeper did not officially know, or did not know, as a matter of fact, that I had made that deposit until the end of the month. Therefore, when she balanced her bank account, she found she was $3,250 out on her bank account.

And if you will look on that exhibit—

The Referee: You just go on and tell me how this happened.

The Witness: In balancing her bank account, she found she was $3,250 out, and at that time the books reflected assets composed of the $3,250 and she used it as an outstanding expense item on her bank account. She continued to use that as a continuing open item, although she could have recorded it as a loan from C. V. Ward, but she preferred to leave, of course, all reconciliation of her bank statements after the property was sold until she closed her books February 28, 1953. At the time she closed her books, then she reconciled her statements, items that had not previously been recorded to the books. "It is on every bank statement starting with the bank reconciliation of September, through October, November, December, and January and on the February 28th statement in the reconciliation of her bank account.

The Referee: Did you tell her not to officially record that money on the books?

The Witness: I did not, and I was not even aware that she had balanced her bank account in that way, your Honor." [See also R. pp. 214, to 226.]

I loaned the business money before this and the loans were carried in the same way. "Every time I loaned the company from my personal account it was credited to my drawing account." (See Bankrupt's Exhibit 11.)

MR. BOWERS

Mr. Bowers testified that he gave instructions to the lady bookkeeper for Mr. Ward. [R. p. 392.]

I made inquiries about certain items on the monthly statements, including Mr. Ward's personal items, and Mr. Ward gave me a list of the items.

APPENDIX NO. 2.

Explanation of Garibaldi and Navajo Transactions.

In December, 1951, Garibaldi Brothers ordered $13,-419.87 in tires from Ward. The cost price of these tires was $10,746.50 and is reflected in some of the figures in evidence. At Mr. Bowers' suggestion, this item was carried upon the books of Ward as "Reserve for committed sales" and if my memory serves me correctly it was carried at the cost price of $10,746.50 [Beginning R. pp. 588 to 672.]

Although Garibaldi Brothers bought a large number of tires during 1952 from Mr. Ward subsequent to the aforementioned order, this particular order was not called for or supplied. (See testimony of Dave Garibaldi and Ward). Mr. Ward's affidavit, in resistance to an affidavit filed herein by Mr. Bernfeld, shows that Mr. Ward discovered on or about February 28, 1953, that this reserve was still being carried on the monthly statements and had not been removed from same. Therefore, Mr. Ward had it removed from the February 28, 1953 statement.

The sales made to Garibaldi during 1952 were in fact substitute sales for the order of December, 1951. Mr. Dave Garibaldi testified that he had frequently placed orders for tires in the month of December, which he expected deliveries upon for the following year. So, therefore, there was nothing unusual or questionable about such a practice. The account receivable from this sale was never factored.

DECEMBER, 1952, ORDER.

In December, 1952, a similar order was given to Mr. Ward for March, April and May, 1953, deliveries. This merchandise was to be paid for in the months of delivery. U. S. Rubber at first agreed to this arrangement, issued an invoice thereon, and set the tires aside from the consigned merchandise. Bankrupt's Exhibits on file support this statement, notwithstanding the fact that U. S. Rubber subsequently tried to back out from the arrangement.

Dave Garibaldi approved these orders by signing his name "Dave" thereon, which did not indicate a delivery of the merchandise but rather an approval of the order. This constituted a memo in writing, sufficient to bind the parties under Section 1624a of the Civil Code—Statute of Frauds section.

After Ward received this order from Mr. Garibaldi and had Garibaldi's approval thereon, he factored the account with Pasadena Finance and Mr. Ward's cancelled checks will disclose that U. S. Rubber received the benefit of the money obtained from the factoring of this account. This money was not applied upon the payment of the Garibaldi tires, as they were not to be paid for until March, April and May, 1953, but it was applied upon other obligations. U. S. Rubber was paid the Garibaldi money received in March and April, 1953, and was given a check by Mr. Ward for the May, 1953, payment, but U. S. Rubber refused to cash the same and soon thereafter brought the attachment suit, which resulted in this bankruptcy.

Although, as we have hereinbefore pointed out, U. S. Rubber originally agreed to the sale arrangement to Garibaldi and for the delivery and payment in March, April

and May, 1953, and had the tires withdrawn from consignment for this purpose (see Exhibits thereon), it subsequently tried to back out of the deal and compelled Mr. Ward to return the 100 tires back into consignment stock; but, notwithstanding this fact, these tires were delivered to Garibaldi in March, April and May, 1953, as originally agreed and when delivered to Garibaldi were received by "Fred"; the slips show "Received by Fred" (see Exhibits). So, it will be seen that the word "Dave" on the invoice only represents approval of the order by Dave Garibaldi, and was not intended as a receipt for the merchandise.

During the month of February, 1953, Pasadena Finance was acquiring more accounts receivable from Ward than they felt justified in carrying from one dealer. Pasadena Finance, therefore, requested Mr. Ward to factor some of the accounts elsewhere. Mr. Ward then factored the Garibaldi account with Atlas Factors and from the moneys so received paid off Pasadena Finance. *There was no double factoring at all as claimed. It was a simple change of factors.*

So, we see that the Garibaldi sale of December, 1952, was a bona fide sale, recognized under Section 1624 Civil Code; that it was carried to completion as agreed; that Garibaldi received the merchandise in March, April and May, 1953, and paid the bill in those months; that although Ward factored this account, U. S. Rubber got the full benefit of this money at or about the time it was received; that thereafter U. S. Rubber was paid on the Garibaldi account in March and April and was given a check in May, 1953, but refused to cash it and attached instead.

Each and all of the finance companies were paid in full and no one was injured in an way, and it was never intended that anyone should be defrauded or injured.

Navajo Transaction.

The Navajo Freight Lines ordered 36 tires for future delivery. Later, instead of taking these particular tires, it ordered 30 tires of a different kind, then the sale of the 36 tires was reversed to correct the entry on the books. This account was factored, and the finance company was paid in full. Navajo did hauling for U. S. Rubber and was required by U. S. Rubber to purchase a large number of tires in order to get the hauling business. These tires were purchased by Navajo through such an arrangement. Navajo paid Ward and Ward in turn paid U. S. Rubber. [R. pp. 883, to 908.]

There was nothing mysterious, wrong or irregular about the transaction and U. S. Rubber was fully aware of what was going on. It requested Ward to get the order and it delivered the tires to Navajo. Triester stipulates [R. p. 884.]

If Mr. Ward's statement did not reflect the true facts, he intended it to do so. He knew that U. S. Rubber was as familiar with all the facts as he was, regardless of the monthly statement. As hereinabove pointed out, there is a big difference between an incorrect statement and a false statement.